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CHARLES ELMORE

No. 99

In the Supreme Court of the United States

OCTOBER TERM, 1929

ROBERT H. LUCAS, AS COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

GUY C. EARL

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR PETITIONER

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OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 8–9) is reported in 10 B. T. A. 723. The opinion of the United States Circuit Court of Appeals (R. 18–20) is reported in 30 F. (2d) 898.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered February 25, 1929. (R. 21.) Petition for writ of certiorari was filed May 20, 1929, and granted October 14, 1929. (R. 22.)

The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

A written agreement, entered into in 1901, between respondent and his wife, provided that the property which either of them owned, and which either of them might thereafter receive or acquire, was to be received, held, and owned by them as joint tenants. The sole question is whether this agreement cut in half the compensation for personal service taxable to the respondent in 1920 and 1921, or whether his salary and fees remained taxable to him as an entirety.

STATUTES INVOLVED

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1062, 1064, 1065:

> SEC. 210. That * * * there shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax * * *.
>
> SEC. 212. (a) That in the case of an individual the term "net income" means the gross income as defined in section 213, less the deductions allowed by section 214.
>
> SEC. 213. That for the purposes of this title * * * the term "gross income"—
>
> (a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of what-

ever kind and in whatever form paid, or from professions * * *.

SEC. 211. (a) That * * * there shall be levied, collected, and paid for each taxable year upon the net income of every individual, a surtax * * *.

Sections 210, 211 (a), 212 (a), and 213 of the Revenue Act of 1921, c. 136, 42 Stat. 227, are similar to the provisions of the 1918 Act above quoted.

STATEMENT

The Board of Tax Appeals made the following findings of fact (R. 7–8):

The respondent is a resident of California. On June 1, 1901, he entered into a contract in writing with his wife, Ella F. Earl, as follows:

> It is agreed and understood between us that any property either of us now has or may hereafter receive or acquire (of any and every kind) in any way, either by earnings (including salaries, fees, etc.) or any rights by contract or otherwise during the existence of our marriage, or which we or either of us may receive by gift, bequest, devise or inheritance, and all the proceeds, issues and profits of any and all such property shall be treated and considered and hereby is declared to be received, held, taken and owned by us as joint tenants and not otherwise with the right of survivorship.
>
> (Signed) GUY C. EARL.
> ELLA F. EARL.

The above agreement has been in effect since its date and all amounts received by the respondent as income from personal services, consisting of salaries, fees, etc., as well as the income from property, have been deposited in a joint bank account.

The respondent and the said Ella F. Earl were married in 1888. In 1901 the respondent had accumulated considerable property, consisting of cash, bonds, lands, and other property. The respondent's wife had about $30,000 worth of property when they entered into the agreement above set out. At the time the respondent was not very well and suggested to his wife that it might be wise for them to enter into such an agreement, which would simplify affairs in case he died during her lifetime, and that "it would take care of her and leave the matter for her administration."

At approximately the same time the contract was entered into the joint bank accounts were made.

The respondent's salary as an officer of the Great Western Power Company and fees received as an attorney were deposited in these joint accounts immediately upon receipt thereof. Mrs. Earl has at all times had the right to draw against the accounts at will.

In the year 1920 the respondent received as salary, fees, etc., the sum of $24,839, and in the year 1921 he received from the same sources $22,946.20.

The respondent included only one-half of the above amounts in his income-tax returns for the

years involved. The Commissioner determined that the entire amount of such income was taxable to the respondent and that no part thereof was taxable to the wife.

SPECIFICATION OF ERRORS

The Circuit Court of Appeals erred:

I. In reversing the decision of the Board of Tax Appeals.

II. In holding that under the agreement between the respondent and his wife the personal earnings of the respondent became the joint property of him and his wife as soon as earned and became taxable one-half to each.

III. In not holding that the personal earnings of the respondent were taxable in their entirety to him.

SUMMARY OF ARGUMENT

Congress has sought to tax each individual upon the gain derived from his labor. To that end it is prescribed that the gross income shall include "income derived from salaries, wages, or compensation for personal service." The gain derived from labor can be *salary* only to the person who has performed the services and the statute imposes a tax upon it as an entirety. The purpose of Congress can not be defeated by an agreement—such as respondent made with his wife—that his earnings, including salaries and fees, shall be received by him and his wife as joint tenants. The courts have held that similar divisions of income from prop-

erty are ineffective for income tax purposes. The same rule should be followed with respect to income from labor.

ARGUMENT

Sections 210 and 211 of the Revenue Acts of 1918 and 1921 impose a normal tax and surtax upon the net income of every individual. Section 212 of the statute defines net income as the gross income as defined in Section 213, less the deductions allowed by Section 214. Section 213 defines gross income and includes therein "gains, profits, and income derived from salaries, wages, or compensation for personal service." A personal exemption is granted each taxpayer by Section 216, and the later statutes further provide for a credit in favor of earned income.

We submit that salaries, wages, and compensation for personal services are to be taxed as an entirety and therefore must be returned by the individual who has performed the services which produced the gain. Salaries, wages, and compensation for personal services are familiar terms, descriptive of the gain derived from labor. That gain can be *salary* only to the person who has performed the services. (Cf. *Old Colony Tr. Co.* v. *Comm'r. Int. Rev.*, 279 U. S. 716, 729–730, and cases there cited.) If it is paid directly to some one else, it is nevertheless chargeable to the person who has performed the services. In such a case the money received by the third person is not compensation for personal services as to him, and whether it is in-

come to him at all depends upon the consideration which he gave for it. So long as money is compensation for personal services it is income to the employee, and Congress sought to tax it as income to the employee before it assumed a different character to some one else.

Even if it be conceded that the assignee's interest vests in the salary *eo instanti,* when it is earned, and that such assignee is entitled to receive the same direct, that is not determinative of the question here. The fact that a taxpayer did not, and was not entitled to, receive the salary which he earned, because of an agreement with a third person, would not make the salary any the less taxable income to him. Such a situation is not different in principle from that arising when salary is taken on an attachment proceeding. Nor does it differ in principle from an assignment of salary to take care of instalment payments due on the purchase price of property. In each of these cases, although part or all of the salary has not been actually received by the person earning it, it is none the less income taxable to him, in the contemplation of the law.

As between themselves the agreement may have given Mrs. Earl a half-interest in her husband's earnings. But they were his earnings and came within the statutory definition of income derived from personal services. The fact that the wife has an interest in the salary does not relieve the husband from liability to pay an income tax on the whole salary. Cf. *United States* v. *Robbins,* 269 U. S. 315, 327.

The decision of the court below is not restricted in its application to community property states. Neither is it restricted to husband and wife. It is a decision of general application. If it is sound, it would seem that any valid assignment of the right to receive salary which has been earned would have the same result. It would also be possible for any person having income from personal services, by agreement with his immediate family, to split up his salary to such an extent that surtaxes, and possibly all taxation, could be avoided.

The recent decision in *Taft* v. *Bowers*, 278 U. S. 470, shows that Congress may effectively deal with attempts to defeat its purpose to take part of all gain derived from capital investments. In that case the Court upheld a Federal statute making the donee accountable upon sale of property received by gift for the entire gain measured by the cost to the donor. It was there recognized that by a mere gift of property to another and a subsequent sale thereof the Government could not be deprived of the right to take by taxation a part of the entire gain, as defined by the Revenue Acts, derived from such sale.

So in this case, we submit that the purpose of Congress to tax as an entirety the compensation of an individual from personal services rendered by him may not be thwarted by any agreement which attempts to convert the gain derived from the ef-

forts of a single individual into compensation for two individuals.

The courts have held that somewhat similar divisions of income are ineffective for tax purposes.

In *Mitchel* v. *Bowers* (C. C. A. 2d), 15 F. (2d) 287 (certiorari denied, 273 U. S. 759), the taxpayer, a member of a partnership, had agreed with his wife that she should be entitled to one-half of the profits which should come to him from the firm and should be liable to pay one-half of the losses which he might sustain by reason of his partnership. Settlements were to be made annually, and the contract might be terminated at the option of either party at any time. The contract was filed with the firm, which was directed to credit and pay over to the wife as they accrued the profits to which she became entitled under the terms of the contract. Thereupon the firm credited to the account of the wife as they accrued one-half of the husband's profits, making them subject to her absolute disposition. Because of this agreement the husband contended that he should be assessed for only one-half of his share of the partnership profits. This contention was denied, not only because of the provision for termination of the contract, but also upon the larger consideration that the entire income of a partnership must be accounted for by the partners. The court said (p. 289):

> Moreover, taken more at large, the sections were in our judgment meant to read compre-

hensively. Their purpose was to reach all the firm income by taxing the partners individually. It would be a denial of that purpose to suppose that all the firm profits might not be taxable against the partners, but might have to be reached under other sections of the statute. Certainly it can not be argued that the wife could be taxed under these sections. Therefore, if the plaintiff be right, they allowed some part of the firm income to escape, and left it to be caught elsewhere. This we think they pretty clearly forbid. Any mediate arrangement by which a partner shared what he might get after he got it did not, therefore, put him outside the scope of such provisions, even if he reserved no power to terminate the contract.

In *Willard C. Hill* v. *Commissioner* and *William H. Plumer* v. *Commissioner* (C. C. A. 1st), decided January 23, 1930, not yet reported, members of a partnership attempted to divide partnership profits with the estate of a deceased member which did not succeed to the decedent's interest in the partnership, and contended that the payments to the estate were not a part of the partners' income. It was held that the partners must account for all of the partnership profits, and that since the estate was not a member of the partnership the sums paid to it must be treated as the income of the partners.

See also *Walter S. Benedict* v. *Warren G. Price* (E. D. N. Y.), decided November 26, 1929, not yet reported; *Bing* v. *Bowers,* 22 F. (2d) 450.

In *Maud Dunlap Shellabarger* v. *Commissioner*, 14 B. T. A. 695, 699, it was said:

> The Board cases hold that where the taxpayer retains his interest in the property or fund from which the income was derived, the income is taxable to him and not to the person who eventually receives the money. (Citing cases.)

We submit that none of the cases cited by respondent in his brief in opposition to our petition is contrary to our contentions.

In *Bowers* v. *New York Trust Co.* (C. C. A. 2d), 9 F. (2d) 548, the partners of a selling agency for a group of mills agreed that in consideration that one of the partners, Cannon, give up his right under an earlier partnership contract to 60% of the gross receipts the partnership would act as selling agent for three of the mills without compensation. The mills agreed to pay for this service stipulated commissions to Cannon and certain other members of his family. The court held that the commissions paid by such mills to the family of Cannon were not taxable as income of the partnership. The reasoning of the opinion was that the former payments never had been partnership income, but consideration which Cannon meant to require the partnership to pay him for doing business with it at all. Had the facts of that case created a situation comparable to that existing in the instant case, it is clear that the principle for which we contend

would have been sustained, for the court said (p. 550):

> To take the present case, one might suppose that the partners were to divide between them all the firm contracts with the several mills, and each was to make a contract with the firm not to collect any of the commissions due upon any of them. Acting upon such contracts, each might persuade the mills to pay him the commissions upon the contracts assigned to him, leaving the firm as the worker, while the partners, the drones, sucked the honey. It may well be that such an arrangement would be regarded as merely a device for sharing the profits, and that the commissions would remain firm income under the tax laws. For the purposes of argument we will assume that this is so.

In *O'Malley-Keyes* v. *Eaton,* 24 F. (2d) 436, and *Young* v. *Gnichtel,* 28 F. (2d) 789, cited by respondent, District Courts held that the income paid by virtue of an assignment was not taxable to the assignor. But each involved an assignment by a beneficiary of a vested interest in a trust fund.

The respondent also relies on the cases of *Wren* v. *Wren,* 100 Cal. 276; *Cullen* v. *Bisbee,* 168 Cal. 695; and *Kaltschmidt* v. *Weber,* 145 Cal. 596, in which it was held that husband and wife may make a valid agreement whereby they relinquish the right to income as community property in favor of the member of the family earning the income. The most that can be said of these cases is

that they recognize the right of a husband and wife to modify the effect of the community property law with reference to their respective earnings which, except for that law, would have been their separate income and property. The effect given the present agreement by the decision of the Circuit Court of Appeals operates not merely to modify the provisions of the community property law but also to nullify the intent of Congress to tax compensation from personal earnings as an entirety, and creates the anomalous situation of converting for tax purposes the personal earnings and income of the husband into the separate income of his wife.

CONCLUSION

In view of the foregoing it is respectfully submitted that the judgment of the Circuit Court of Appeals should be reversed.

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